

REPORT OF EXAMINATION  
OF THE  
TOPA INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2009

Participating State  
and Zone:

California

Filed September 30, 2010

# TABLE OF CONTENTS

	<u>PAGE</u>
SCOPE OF EXAMINATION .....	1
COMPANY HISTORY .....	2
MANAGEMENT AND CONTROL:.....	3
Management Agreements .....	4
Intercompany Agreements .....	5
TERRITORY AND PLAN OF OPERATION .....	7
REINSURANCE: .....	8
Assumed .....	8
Ceded .....	8
FINANCIAL STATEMENTS: .....	11
Statement of Financial Condition as of December 31, 2009 .....	12
Underwriting and Investment Exhibit for the Year Ended December 31, 2009.....	13
Reconciliation of Surplus as Regards Policyholders from December 31, 2006 through December 31, 2009.....	14
COMMENTS ON FINANCIAL STATEMENT ITEMS:.....	15
Losses and Loss Adjustment Expenses: .....	15
SUMMARY OF COMMENTS AND RECOMMENDATIONS: .....	15
Current Report of Examination .....	15
Previous Report of Examination.....	15
ACKNOWLEDGEMENT .....	17

Los Angeles, California  
August 20, 2010

Honorable Alfred W. Gross  
Chairman of the NAIC Financial  
Condition Subcommittee  
Commissioner of Insurance  
Virginia Bureau of Insurance  
Richmond, Virginia

Honorable Christina Urias  
Secretary, Zone IV-Western  
Director of Insurance  
Arizona Department of Insurance  
Phoenix, Arizona

Honorable Steve Poizner  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Chairman, Secretary, and Commissioner:

Pursuant to your instructions, an examination was made of the

#### TOPA INSURANCE COMPANY

(hereinafter also referred to as the Company) at the statutory home office and the primary location of its books and records, 1800 Avenue of the Stars, Los Angeles, California 90067.

#### SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2006. This examination covers the period from January 1, 2007 through December 31, 2009. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2009, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; accounts and records; and sales and advertising.

### COMPANY HISTORY

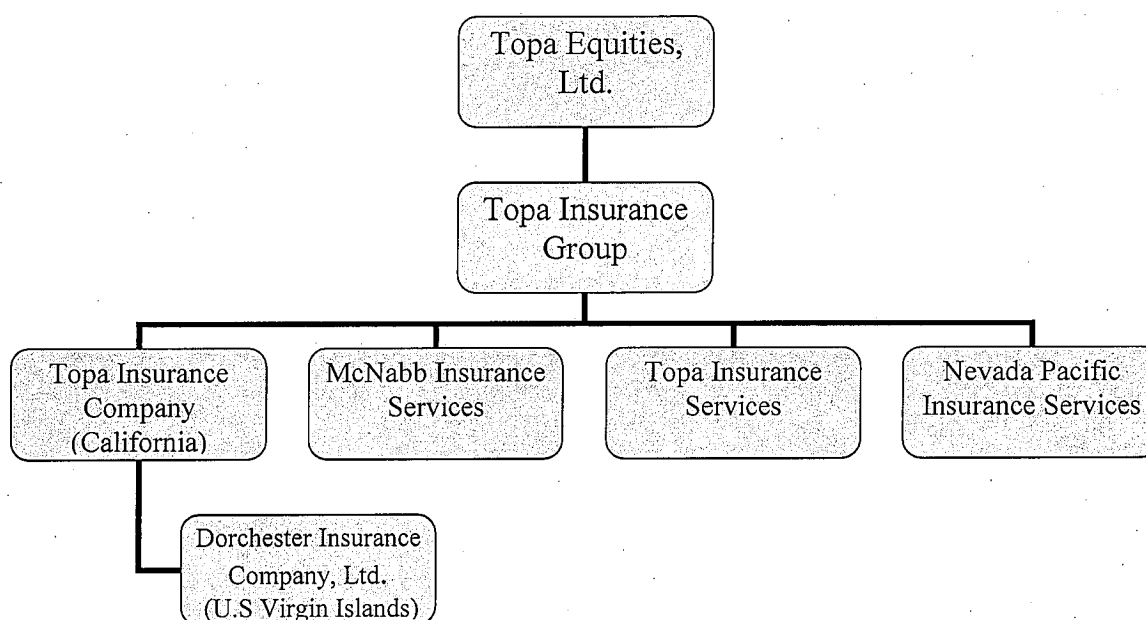
The Company was incorporated under the laws of the State of California on October 4, 1984 and commenced business on January 1, 1985. Prior to the receipt of its certificate of authority, the Company issued 52,000 shares of stock to Topa Capital Corporation (TCC). On December 31, 1985, the Company issued 28,000 shares as a stock dividend to its parent. Upon the 1990 dissolution of TCC, all of the stock of the Company was transferred from TCC to Topa Equities, Ltd. (TEL), who was sole shareholder of TCC prior to its dissolution. In April 1997, the stock of the Company was transferred to Topa Insurance Group (TIG) from TEL. TEL is the owner of 100% of the stock of TIG.

The Company has 200,000 authorized shares of common stock, 80,000 shares of which were outstanding. On September 6, 2006, the Company amended its Articles of Incorporation to restate its par value from \$32.50 to \$62.50 per share. This change increased common stock by \$2,400,000 and decreased gross paid-in and contributed surplus by the same amount. The Company filed a notice with the California Department of Insurance on April 9, 2007.

During the period covered by this examination, the Company paid dividends to its parent in the amounts of \$1,600,000, \$1,640,000 and \$600,000 for the years 2007, 2008, and 2009, respectively. The dividends were considered ordinary and did not require prior approval.

## MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which Mr. John E. Anderson is the ultimate controlling person. The following is an abbreviated organizational chart depicting the relationship of the Company within the holding company system:



(\*) all ownership is 100%

Management of the Company is vested in a five-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2009 follows:

### Directors

#### Name and Residence

John E. Anderson  
Los Angeles, California

#### Principal Business Affiliation

President and Chairman of the Board  
Topa Equities, Ltd.

Name and ResidencePrincipal Business Affiliation

John E. Anderson, Jr.  
Los Angeles, California

Executive Vice President  
Topa Equities, Ltd.

Noshirwan Marfatia  
St. Thomas, U.S. Virgin Islands

President and Chief Executive Officer  
Topa Insurance Company

Judith Munzig  
Ojai, California

Director  
Topa Insurance Company

Brenda Seuthe  
Los Angeles, California

Chief Financial Officer  
Topa Equities, Ltd.

Principal OfficersNameTitle

John E. Anderson  
Noshirwan Marfatia  
John E. Anderson, Jr.  
Daniel Sherrin

Chairman of the Board  
President and Chief Executive Officer  
Vice President and Secretary  
Vice President, Chief Financial Officer, and  
Treasurer  
Vice President  
Vice President

Olha Tiberg  
Patrick Sessions

Management Agreements

Investment Management Agreement: On September 6, 1993, the Company entered into an investment management agreement with Kayne, Anderson Investment Management, Inc. (KAIM). Mr. John E. Anderson, the Company's ultimate controlling person and also a director of KAIM, previously held a 25% ownership interest in KAIM. Under this agreement, the Company retains KAIM to supervise and manage its invested assets. The agreement specifies a monthly management fee of \$20,000 for these services. On December 1, 2000, KAIM changed its legal name to Kayne Anderson Rudnick Investment Management, LLC (KARIM). On October 1, 2001, the California

Department of Insurance approved the amended and restated investment management agreement. The amended agreement also increased the management fee from \$20,000 to \$27,500 per month.

On November 1, 2001, Phoenix Investment Partners, Ltd. acquired 60% of interest in KARIM. In 2005 John Anderson sold his remaining interest to Phoenix Investment Partners, Ltd.

### Intercompany Agreements

Office Lease Agreement: On August 22, 1995, the Company, entered into an Office Lease Agreement with its ultimate parent, Topa Equities, Ltd, (TEL). The lease was renewed effective October 1, 2005, and allowed to expire January 31, 2009. The renewed lease was approved by the California Department of Insurance (CDI) on September 5, 2005. In November 2003, the Company entered into a separate lease agreement with Topa Management Company (TMC), a wholly-owned subsidiary of TEL. The TMC lease agreement was renewed on February 1, 2009 expiring February 1, 2014, and was approved by the CDI on December 1, 2008. During the examination period the Company paid its affiliates rental fees of \$ 2,636,179.

Tax-Savings Agreement: On January 1, 1998, the Company entered into a Tax-Savings Agreement with its ultimate parent, TEL. Under the terms of the agreement the Company and TEL, file a consolidated federal income tax return. The Company's tax liability, is no more than what it would have been had it filed on a separate stand-alone basis. During the examination period under the Company paid TEL \$2,464,164 under the Tax-Savings Agreement. Although prior approval was not required at the time it was entered into, the Company submitted the Tax-Savings Agreement to the CDI for review.

Brokerage Agreement: On February 5, 1996, the Company entered into a brokerage agreement with its affiliate, Topa Insurance Services, Inc. (TISI). Under the terms of this agreement, TISI, as a broker, is not authorized to bind insurance unless prior submission is made and written approval is obtained from the Company. TISI receives a commission based on a negotiated rate on a per policy

basis. The Company paid TISI commissions of \$109,429, \$105,437, and \$95,103 for the years 2007, 2008, and 2009, respectively.

Agency Agreement: On February 1, 2002, the Company entered into an agency agreement with its affiliate, McNabb Insurance Services, Inc. (McNabb), which was approved by the CDI on December 20, 2002. Under the terms of this agreement, McNabb is authorized to bind personal and commercial lines of business written in California (within specified limits). The Company paid McNabb commissions of \$3,279,486, \$3,691,067, and \$3,545,369 for the years 2007, 2008, and 2009, respectively, which approximates a 25% commission rate for the period under exam. The non-affiliated commission rates range from 15% to 30% depending on the line of business.

Agency Agreement: On February 1, 2002, the Company entered into an agency agreement with its affiliate, Nevada Pacific Insurance Services, Inc. (Nevada Pacific), which was approved by the CDI on December 20, 2002. Under the terms of this agreement, Nevada Pacific is authorized to bind personal and commercial lines of business written in Nevada (with specified limits). The Company paid Nevada Pacific commissions of \$1,965,039, \$1,265,623, and \$1,241,762 for the years 2007, 2008, and 2009, respectively, which approximates a 26% commission rate for the period under exam. The non-affiliated commission rates range from 15% to 30% depending on the line of business.

Contingent Commission (Profit Sharing) Agreements: Effective January 1, 2003, the Company entered into contingent commission agreements with McNabb and Nevada Pacific. Both agreements were approved by the CDI on December 31, 2003. The Company paid McNabb contingent commissions of \$769,590, \$912,814, and \$786,135 for the years 2007, 2008, and 2009, respectively. There were no contingent commissions paid to Nevada Pacific during the examination period.



## TERRITORY AND PLAN OF OPERATION

As of December 31, 2009, the Company is licensed to transact insurance in Arizona, California, Colorado, District of Columbia, Georgia, Iowa, Kansas, Maryland, Missouri, Nebraska, Nevada, Oklahoma, South Carolina, Utah, and Virginia. It operates on a surplus lines basis in the U.S. Virgin Islands and in the following states: Alabama, Florida, Hawaii, Illinois, Michigan, North Carolina, Ohio, Oregon, Tennessee, Texas, Washington, and Wisconsin.

For the year ended December 31, 2009, the Company's direct written premiums were \$91.7 million. The following reflects the largest premium producing states and territories:

<u>State and Territories</u>	<u>Premium Volume</u>	<u>% of Total</u>
California	80,584,158	88%
Nevada	4,090,654	4%
Oklahoma	2,376,337	3%
Arizona	787,836	1%
U.S. Virgin Islands	744,355	1%

The Company's overall premium production is approximately 65% commercial lines and 35% personal lines. The Company's commercial coverages emphasize commercial automobile, commercial multi-peril, general liability, and workers' compensation. Workers' compensation coverage is written only for the Company's ultimate parent Topa Equities, Ltd. Personal lines operations consist of private passenger automobile and a small book of homeowner's business. Personal lines business is distributed through independent agents. Specialty commercial lines products are distributed through wholesale brokers.

## REINSURANCE

### Assumed

The Company assumes a minimal amount of commercial property reinsurance, covering risks originating in the US Virgin Islands, from its wholly-owned subsidiary, Dorchester Insurance Company, Ltd. The following is the summary of the Company's assumed reinsurance:

Type of Contract	Reinsured Name	Reinsured's Retention	Company's Maximum Limits
Property (Catastrophe) Excess of Loss Treaty	Dorchester Insurance Company, Ltd.	\$250,000 per occurrence	\$250,000 excess of \$250,000— one occurrence \$750,000 – aggregate
Property (Catastrophe) Excess of Loss Treaty	Dorchester Insurance Company, Ltd.	\$6 million per occurrence	\$1 million excess of \$6million- per occurrence and aggregate
Property (Non-Catastrophe) Excess of Loss Treaty	Dorchester Insurance Company, Ltd.	\$100,000 per occurrence	\$100,000 excess of \$100,000— one occurrence \$750,000 – aggregate

### Ceded

The following is a summary of the Company's ceded reinsurance in force as of December 31, 2009:

Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Maximum Limits
Property Damage Quota Share excluding Windstorm	55.00% Everest Reins Co 29.00% Allianz SE <u>Unauthorized</u> 16.00% Amlin Bermuda Ltd	10% of \$2 million per risk	90% of \$2 million per risk \$65 million maximum aggregate for earthquakes

Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Maximum Limits
Real Estate Agents Errors & Omissions Excess Of Loss	13.50% Hannover Ruck 25.00% QBE Reinsurance 21.50% Toa Reinsurance 25.00% White Mountain Re	\$250,000 per occurrence plus 15% of \$750,000 Excess of \$250,000	\$750,000 Excess of \$250,000
1 <sup>st</sup> Property Excess of Loss	20.00% Catlin 5.00% Hannover Re 7.50% Odyssey Re 20.00% QBE Re 22.50% Swiss Re 15.00% Toa Re	a) \$250,000 per risk, per occurrence, plus 10% of \$1.25 million excess of \$250,000 (Section A) b) \$200,000 per risk, per occurrence, (Section B) plus 10% of \$1.3 million excess of \$200,000	a) \$1.25 million per risk \$3.125 million per occurrence b) \$1.3 million per risk \$3.5 million per occurrence
Commercial Auto & Truck Liability Excess of Loss	10.00% Hannover Re 25.00% Maiden Re (GMAC) 10.00% Odyssey Re 20.00% QBE Re 20.00% Swiss Re	\$250,000 per occurrence, per policy plus 15% of \$750,000 excess of \$250,000	\$750,000 per occurrence, per policy
1 <sup>st</sup> Casualty Contingency / Clash Excess of Loss	25.00% Hannover Ruck 5.00% Liberty Mutual 7.50% Odyssey Re 17.50% QBE Re 15.00% Toa Re 30.00% White Mountain	Casualty Contingency: a) \$250,000 per occurrence, per policy b) \$275,000 per occurrence, per policy as respects Comml Auto/Truck and Garage business. Clash Coverage: c) \$350,000 per occurrence, involving two or more policies.	\$2 million excess of Company's retention in a, b, & c.
1 <sup>st</sup> Casualty Excess of Loss	37.50% Hannover Ruck 5.00% Liberty Mutual	\$250,000 per occurrence, per policy plus 25% of \$750,000	\$750,000 per occurrence, per policy

Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Maximum Limits
	17.50% QBE Reins. Corp. 15.00% Toa Re	excess of \$250,000	
2 <sup>nd</sup> Casualty Excess of Loss	15.00% Endurance Re 25.00% Hannover Ruck 5.00% Liberty Mutual 17.50% QBE Re 20.00% Swiss Re 15.00% Toa Re	\$1 million per occurrence, per policy plus 2.5% of \$4 million excess of \$1million	\$4 million per occurrence, per policy
1 <sup>st</sup> Layer Catastrophe Excess of Loss	5.00% American Agricultural 5.00% Hannover (Bermuda) 25.50% Munich Re 5.00% QBE re 1.50% Toa Re 7.50% R+V VersicherungAG 24.00% Lloyds Underwriters  <u>Unauthorized</u> 10.00% Mafpre Re Compania 4.00% Amlin Bermuda Ltd 12.50% Paris Re	\$1 million	\$14 million per occurrence \$28 million aggregate

As of December 31, 2009, reinsurance recoverables, for all ceded reinsurance, totaled \$41.8 million or 58.1% of surplus as regards policyholders.

The Company purchases facultative reinsurance for amounts in excess of the Company's retention and limits.

## FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2009

Underwriting and Investment Exhibit for the Year Ended December 31, 2009

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2006 through December 31, 2009

Statement of Financial Condition  
as of December 31, 2009

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 134,609,718	\$	\$ 134,609,718	
Stocks:				
Preferred stocks	668,360		668,360	
Common stocks	25,940,437		25,940,437	
Cash and short-term investments	1,796,836		1,796,836	
Receivable for securities	252,156		252,156	
Investment income due and accrued	2,083,600		2,083,600	
Premiums and agents balance in course of collection	6,134,089		6,134,089	
Premiums, agents' balances and installments booked but deferred and not yet due	7,104,171		7,104,171	
Amounts recoverable from reinsurers	1,298,007		1,298,007	
Current federal income tax recoverable	406,482		406,482	
Net deferred tax asset	7,037,936	3,353,481	3,684,455	
Electronic data processing equipment	2,918,422	2,743,468	174,954	
Furniture and equipment	10,680	10,680	0	
Aggregate write-ins for other than invested assets	<u>1,440,896</u>	<u>58,696</u>	<u>1,382,200</u>	
Total assets	<u>\$ 191,701,790</u>	<u>\$ 6,166,325</u>	<u>\$ 185,535,465</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 74,736,442	(1)
Loss adjustment expenses			5,817,102	(1)
Commissions payable, contingent commissions and other similar charges			1,445,500	
Other expenses			1,643,509	
Unearned premiums			27,475,019	
Ceded reinsurance premiums payable			2,186,538	
Amounts withheld or retained by company for the account of others			69,565	
Payable to parent, subsidiaries and affiliates			130	
Payable for securities			15,347	
Aggregate write-ins for liabilities			<u>158,442</u>	
Total liabilities			113,547,594	
Common capital stock		\$ 5,000,000		
Gross paid-in and contributed surplus		23,639,733		
Unassigned funds (surplus)		<u>43,348,138</u>		
Surplus as regards policyholders			<u>71,987,871</u>	
Total liabilities, surplus and other funds			<u>\$ 185,535,465</u>	

Underwriting and Investment Exhibit  
for the Year Ended December 31, 2009

Statement of Income

Underwriting Income

Premiums earned		\$ 83,961,906
Deductions:		
Losses incurred	\$ 46,304,684	
Loss expense incurred	11,711,162	
Other underwriting expenses incurred	<u>27,256,714</u>	
Total underwriting deductions		<u>85,272,560</u>
Net underwriting loss		(1,310,654)

Investment Income

Net investment income earned	\$ 6,451,506	
Net realized capital gains	<u>33,091</u>	
Net investment gain		6,484,597

Other Income

Net loss from agents' balances charged off	<u>\$ (22,970)</u>	
Total other income		<u>(22,970)</u>
Net income before federal income taxes		5,150,973
Federal income taxes incurred		<u>(296,974)</u>
Net income		<u>\$ 5,447,947</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2008		\$ 61,170,743
Net income	\$ 5,447,947	
Change in net unrealized capital gains	7,143,713	
Change in deferred income tax	(3,038,191)	
Change in non admitted assets	1,863,659	
Dividends to stockholders	<u>(600,000)</u>	
Change in surplus as regards policyholders		<u>10,817,128</u>
Surplus as regards policyholders, December 31, 2009		<u>\$ 71,987,871</u>

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2006 through December 31, 2009

Surplus as regards policyholders, December 31, 2006,  
per Examination \$ 74,116,363

	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>
Net income	\$17,273,643	\$
Net unrealized capital losses		12,103,076
Change in net deferred income tax		418,110
Change in nonadmitted assets		3,040,949
Dividends to stockholders		<u>3,840,000</u>
Totals	<u>\$ 17,273,643</u>	<u>\$ 19,402,135</u>

Net decrease in surplus as regards policyholders (2,128,492)

Surplus as regards policyholders, December 31, 2009,  
per Examination \$ 71,987,871



## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Losses and Loss Adjustment Expenses

A Casualty Actuary from the California Department of Insurance reviewed the Company's reserves for loss and loss adjustment expenses as of December 31, 2009 and found them to be reasonably stated. Subsequent to the examination, as of June 30, 2010, the Company reported adverse loss development of approximately \$2 million. No examination adjustment was made as the amount is not material.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

None.

### Previous Report of Examination

Company History (Page 2): It was recommended that the Company submit future changes to its common stock and gross paid-in capital to the California Department of Insurance (CDI) in a timely manner as required by California Insurance Code (CIC) Section 827.3(b)(3). The Company has agreed to submit said filings to the CDI in a timely manner.

Corporate Records (Page 7): It was recommended that the Company implement procedures in its board meetings to ensure compliance with CIC Section 735. A review of the board of director minutes indicated that the Company is now in compliance with CIC section 735.

Electronic Data Processing Equipment and Software (Page 17): It was recommended that the Company not admit non operating system software in accordance with Statements of Statutory Accounting Principles No. 16 Section 2. The Company has complied.

## ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/

Constance J. Korte, CFE  
Examiner-In-Charge  
Department of Insurance  
State of California